Exploring Superannuation to Buy Property: Shares vs Real Estate

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Are you contemplating using your superannuation to invest in property? This popular investment strategy has the potential to provide significant tax benefits and long-term growth. However, navigating the complexities of superannuation property investment can be daunting. In this blog post, we'll explore the advantages and disadvantages of using superannuation to buy property, delve into the world of Self-Managed Super Funds (SMSFs), and compare property investment with shares. You'll also discover expert tips to help you make informed decisions and maximize your returns.

Key Takeaways

- Investing in property through Superannuation offers potential tax advantages and long-term growth, but comes with associated risks.
- Property investments offer lower volatility than shares, while shares have historically yielded higher returns.
- Seeking professional advice is essential to ensure informed decision making when investing in superannuation property.

Using Superannuation to Buy Property

Superannuation is a retirement savings account designed for individuals to save for their golden years. Investing in a Self-Managed Super Fund (SMSF) or property-related investments like Real Estate Investment Trusts (REITs) is possible when you utilize superannuation to purchase property. This strategy offers potential tax advantages, such as capital gains tax benefits, long-term growth potential, and the ability to capitalize on equity and debt recycling.

However, there are some drawbacks to using superannuation for property investment. It is a long-term investment, and you may not be able to access your funds until you reach retirement age. Additionally, there are restrictions on how you can use the money in your superannuation account, which may affect your flexibility as a property investor.

Advantages

Property investment, particularly in the Australian market, has historically shown strong capital growth. With values doubling every 9-10 years, the potential for long-term appreciation is significant. Moreover, the historical return on investment for Australian residential property is 10.2%. Evaluating the potential return on investment for property investments requires accounting for transaction costs and other expenses.

Tax advantages are another benefit of property investment. Negative gearing allows deductible expenses to surpass the income earned from the residential investment property, granting access to relevant tax breaks. Additionally, depreciation on improvements can be claimed, reducing the cost to the investor.

Disadvantages

Despite the potential benefits, there are also significant initial outlays and ongoing costs associated with property investment. Some of these costs include:

- Providing a 20% deposit to avoid incurring Lenders Mortgage Insurance (LMI)
- Bank fees
- Legal costs
- Mortgage Insurance
- Building Insurance
- Real estate agent costs
- Stamp duty

All of these costs should be considered when purchasing property, as they can impact property values.

Another drawback is the risk associated with making a poor property choice. If a residential property fails to generate the required yields or the investor overextends themselves, it can be difficult to meet loan requirements. Additionally, there are potential risks and unfavorable aspects associated with property investment, such as difficulty entering the market, expensive initial costs, and lack of liquidity.

Self-Managed Super Funds (SMSFs) and Property Investment

Self-Managed Super Funds (SMSFs) offer a way to invest in property within superannuation, allowing you to diversify your investment portfolio. Property is a widely-utilized investment choice for those with SMSFs, as it is a stable and tangible asset, making it less risky than other common SMSF investment options. However, investing in property through an SMSF requires careful planning and management, as well as adherence to compliance and legal and financial stipulations.

Setting up an SMSF involves a series of steps, including:

- ✧ Researching and familiarizing yourself with SMSFs
- ✧ Establishing a trust
- ✧ Obtaining a trust deed
- ✧ Signing a declaration
- ✧ Lodging an election with the Australian Taxation Office (ATO)
- ✧ Activating the SMSF to commence managing and administering the fund

Ensuring that your SMSF has enough funds for the initial investment and ongoing expenses is a necessary step.

Setting up an SMSF

Establishing an SMSF requires meeting legal requirements, such as establishing a trust, obtaining a trust deed, signing a declaration, and lodging an election with the relevant authorities. Additionally, all members must be trustees or directors of the corporate trustee, and the SMSF must be audited by an independent SMSF auditor licensed by the Australian Securities and Investments Commission. Having a minimum starting balance of at least $200,000, sufficient funds for ongoing expenses, financial and legal knowledge, and a cash account for managing transactions is recommended.

To register an SMSF with the Australian Taxation Office (ATO), you must complete the SMSF trust deed, apply for an Australian Business Number (ABN), and register the SMSF within 60 days of establishment. It is advisable to seek professional advice before setting up an SMSF to ensure that your fund meets all legal and financial requirements.

Borrowing within an SMSF

Borrowing within an SMSF is possible, albeit with certain restrictions. One instance where borrowing is allowed is through a limited recourse borrowing arrangement (LRBA) for the purpose of procuring an eligible asset, such as residential or commercial property. A Limited Recourse Borrowing Arrangement (LRBA) permits the trustee to obtain funds from a third-party lender to invest in a commercial or residential asset. Should the fund default, the lender's recourse is restricted to the property or another single asset that the SMSF loan was utilized to purchase.

Borrowing within an SMSF comes with strict rules and restrictions. Some of these include:

- The lender's recourse in the event of default must be limited to the asset being acquired
- The SMSF cannot lend money or provide financial assistance to its members or their relatives
- There are restrictions on the amount of loans that can be made to related parties.

Managing and Maintaining the Property

Time, effort, and compliance with regulations are required when managing and maintaining a property within an SMSF. As an SMSF trustee, you are responsible for:

- Ensuring compliance
- Managing investments
- Effecting annual property valuation
- Fulfilling reporting obligations
- Adhering to borrowing restrictions
- Overseeing the general management of the SMSF

Compliance with regulatory requirements, such as the sole purpose test, investment strategy development and implementation, and record-keeping, is crucial for maintaining an SMSF property.

Property management within an SMSF comes with tax implications. Here are some key points to consider:

- Rental income received from the property is generally taxed at a concessional rate of 15%.
- SMSFs can claim investment property expense deductions against the rental income they generate.
- When the SMSF sells the property, a rate of 15% tax will apply to the capital gain, unless the fund has owned the property for 12 months or more.

Alternative Strategies for Investing in Property with Superannuation

Besides investing in property through an SMSF, there are alternative strategies for investing in property with superannuation, such as indirect property investments and Real Estate Investment Trusts (REITs). Indirect property investments involve investing in property through vehicles like retail, corporate, or industry super funds, allowing individuals to gain exposure to residential or commercial property without directly owning the property themselves. Investors can achieve this by using real estate investment trusts (REITs), property funds, or exchange-traded funds (ETFs) that invest in property assets.

While indirect property investments and REITs can offer diversification and liquidity benefits, they also come with potential risks, such as variation in value, potential investment losses, and the possibility of fraud. Investing in higher-risk REITs may provide higher distributions but also entails increased risk.

Indirect Property Investments

Indirect property investment involves:

- Purchasing shares in a fund or stocks/shares in companies that invest in real estate
- Allowing investors to gain access to the real estate market without directly owning and managing the properties themselves
- Offering opportunities to invest in various factors, such as market segment, investment strategy, compensation structure, and geographic location
- Reducing risk exposure and generating income without active involvement in property management.

Drawbacks to indirect property investments include a lack of control over the investments, the potential for higher fees, and limited liquidity. It is essential to weigh the benefits and drawbacks of indirect property investments before deciding on an investment strategy.

Real Estate Investment Trusts (REITs)

REITs are a form of real estate investment that enables investors to own a share and benefit from a portfolio of income-generating properties. They can be readily purchased and sold on stock exchanges and provide diversification and liquidity. REITs typically invest in a variety of property types, including:

- Offices
- Apartment buildings
- Warehouses
- Retail centers
- Medical facilities

Investors may diversify their portfolios by exploring various asset classes, such as equity REITs and mortgage REITs, which represent different sectors.

Although REITs provide diversification and potential for attractive returns, they are not without risks. It is essential to understand the specific risks associated with investing in REITs and to carefully select the appropriate REITs that align with your investment objectives and risk tolerance..

Comparing Property Investment with Shares

Comparing Property Investment with Shares Understanding the differences in risk, potential returns, and diversification is crucial when weighing property investment against shares. Both investments have the potential to appreciate in value over time, but there are key distinctions that can impact your investment strategy and financial goals.

Risk and Volatility

Property investments generally have lower volatility than shares, making them a more stable investment option. In the debate of property vs shares, it’s important to consider that shares, on the other hand, are more unpredictable due to their higher volatility and fluctuating prices. The share market, often synonymous with the stock market, is characterized by daily price fluctuations, as shares are regularly being traded, making it a more volatile investment option.

Consequently, property investment can serve as a safeguard against market fluctuations and may be a more secure option for investors seeking stability.

Potential Returns

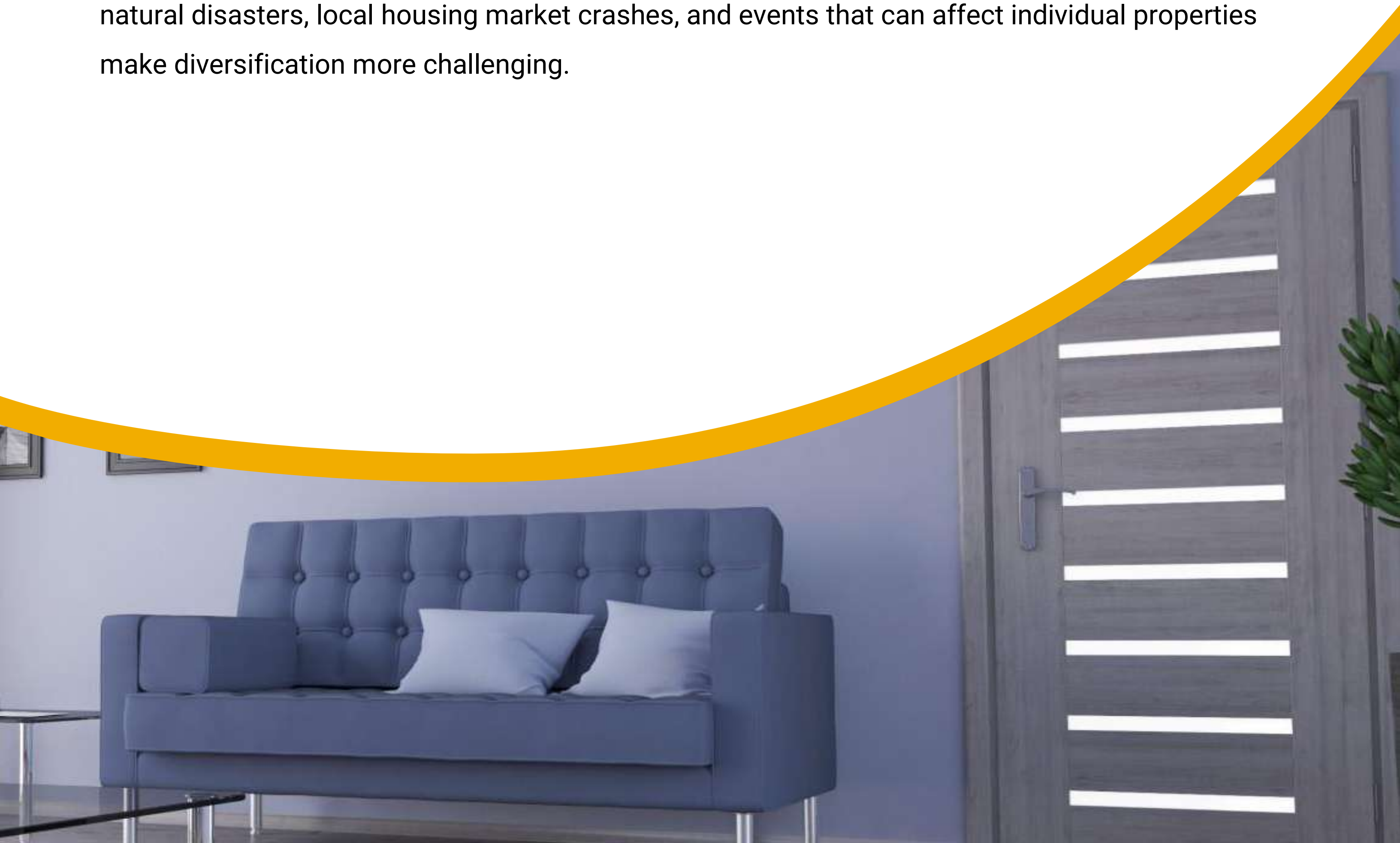
Historically, shares have yielded higher returns, while real estate has provided consistent income streams. The historical return on investment for the Australian stock market is 8.8%, while for Australian residential property, it is 10.2%. Income from shares is generated through dividends, which are payments distributed to shareholders when the company has achieved a positive financial result. Interest rates can influence both the stock market and residential property investments.

In contrast, property investors with rental real estate can anticipate a relatively consistent income stream from their tenants.

Diversification

Diversification is more easily attainable with shares, whereas property investments require considerable capital and effort. Share investors can quickly distribute their capital across different stocks, sectors, and geographic regions, allowing for greater diversification.

Conversely, property investments are highly concentrated, and their exposure to risks such as natural disasters, local housing market crashes, and events that can affect individual properties make diversification more challenging.



Expert Tips for Superannuation Property Investment

You should now have a clearer grasp of the pros and cons of superannuation property investment, as well as the other strategies available to you. To ensure success in your property investment journey, consider the following expert tips: assessing property opportunities, planning for the long-term, and seeking professional advice.

Assessing Property Opportunities

Assessing property opportunities requires rigorous research into the property market, focusing on:

- Market conditions
- Location and potential growth
- Income potential and capital growth
- Market value
- Loan repayments and ongoing expenses
- Potential periods of vacancy
- Risks involved

Thorough research and evaluation of property opportunities enable you to make informed decisions in sync with your financial objectives and risk tolerance.

Long-Term Planning

Long-Term Planning Successful property investment within superannuation requires long-term planning. Consider factors such as retirement goals and investment timeframes when making decisions about property investments. Integrating retirement goals into superannuation property investment planning involves:

1. Establishing one’s retirement goals
2. Assessing one’s superannuation
3. Understanding property investment
4. Harmonizing property investment with retirement goals
5. Diversifying one’s investments
6. Periodically reviewing and adjusting.

Seeking Professional Advice

Navigating the complexities of superannuation property investment can be challenging. Engaging professional advice from financial planners, accountants, and legal experts supports informed decision-making and ensures your fund complies with all legal and financial requirements. Professionals can assist you in establishing and managing your self-managed super fund (SMSF), guaranteeing that you make judicious investment decisions.

Summary

In summary, superannuation property investment offers potential tax benefits, long-term growth, and the opportunity to diversify your investment portfolio. However, it also involves significant upfront costs, ongoing maintenance, and potential regulatory changes. By carefully considering the advantages and disadvantages, exploring alternative strategies such as indirect property investments and REITs, and seeking professional advice, you can make informed decisions and maximize your returns in the long run. Remember, the key to successful property investment within superannuation is assessing property opportunities, long-term planning, and professional guidance.

Frequently Asked Questions

Can I use my super to buy a property?

Yes, you can use your super to buy a property if you have enough to cover the deposit. However, it is generally advised that you consider all other options before making this decision.

How much do you need in super to buy a property?

To purchase a property, you should have 20% of the asking price saved in your superannuation fund as banks typically lend up to 80%.

How much can my super fund borrow to buy property?

SMSF loans generally allow up to 80% loan-to-value ratio (LVR) and 30-year loan terms, with up to five years of interest-only repayments. The minimum loan amount is $50,000 with no set maximum, subject to lender approval of the property and borrowing capacity of the fund.

What is a Self-Managed Super Fund (SMSF)?

A Self-Managed Super Fund (SMSF) is a private superannuation fund that you manage yourself, giving you the flexibility to invest in various assets such as property.

Invest 45 minutes in yourself to see how Strategic Investors Australia can show you a pathway to meeting your Financial Goals through Creating Clarity in your Strategy

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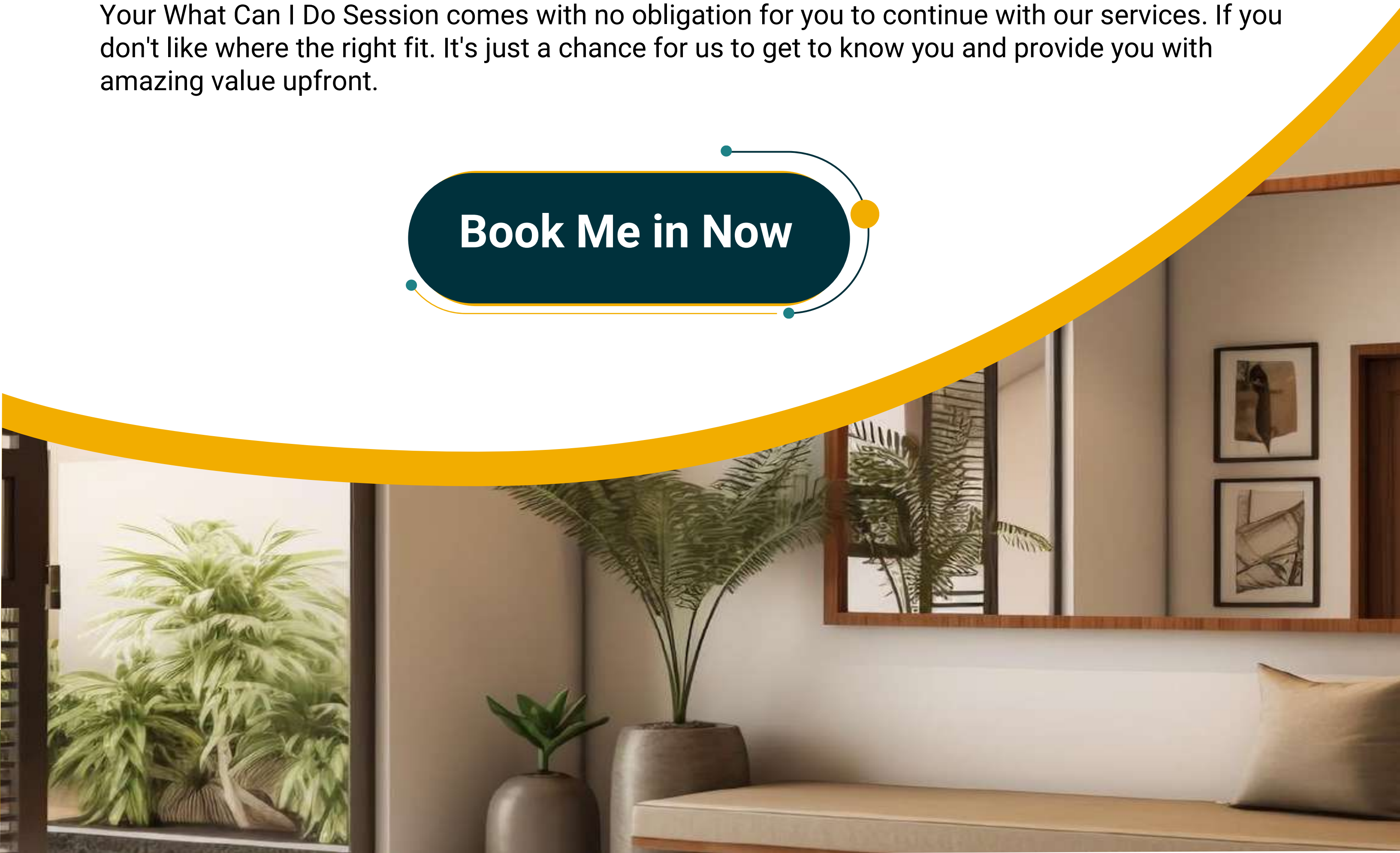

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